

# Preventive insolvency proceedings and European prudential requirements: The French Banks' Dilemma

Anja Droege Gagnier and Elisa Artu write on the recent ruling which creates a direct conflict between the obligations under French and European insolvency law



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**The French Supreme Court (*Cour de Cassation*) has recently ruled that the opening of preventive insolvency proceedings (*conciliation*) is confidential information for the debtor's bank, even if it is not a party to the proceedings, which prevents it from declaring an event of default to its regulator, despite EU Regulation 575/2013 of 26 June 2013 ("Regulation").<sup>1</sup>**

This decision undoubtedly creates a direct conflict between the confidentiality obligations under French insolvency law and the disclosure obligations under European regulatory legislation.

## The case scenario

A French company was the subject of *conciliation* proceedings initiated at the Commercial Court. The Bank was not a party to the *conciliation* but was nevertheless informed by the company of such proceedings. Pursuant to Article 178 of the Regulation, the bank declared a default to its regulator, the Banque de France. Subsequently, the latter downgraded the Company's rating from 5+ to 6 in the FIBEN (French Banking Registry), meaning that the Company's ability to meet its commitments over three years had changed from "weak" to "very weak". The company asked the bank to withdraw the registration of

default and claimed damages, arguing that the opening of a *conciliation* procedure was confidential.

The French Supreme Court ruled that the initiation of a conciliation proceedings "does not constitute an indication of a possible default" within the meaning of Article 178 of the Regulation and that it is confidential information which the bank cannot use to declare a default, even if it is provided to the bank by the debtor itself. Therefore, by declaring a default to the Banque de France, the bank clearly caused an unlawful disturbance (*trouble manifestement illicite*), giving rise to damages to the debtor.

## Consequences for banks in terms of their regulatory obligations

Preventive insolvency proceedings are a powerful tool for restructuring a debtor's financial debts at an early stage. In France, they benefit from strict confidentiality to allow efficient negotiations with the debtor's financial partners without being jeopardised by other creditors or third parties becoming aware of the debtor's difficulties. This principle of confidentiality was the subject of an important decision by the French Supreme Court, which ruled that journalists, although not parties to the proceedings, must respect the principle of confidentiality of such proceedings.<sup>2</sup>

The decision of 3 July 2024 continues the French Supreme Court's trend of increasing the scope of confidentiality in preventive insolvency proceedings. In fact, the French Supreme Court now extends the confidentiality obligation to all persons who, without being party to the preventive insolvency proceedings, are aware of such proceedings, even if the information about the existence of these proceedings is given by the debtor itself. Subsequently, in practice this ruling will prevent banks from reporting a debtor's default to their respective regulatory authority.

But how did the French Supreme Court come to contradict the regulatory requirements to which banks are subject?

Article 178 of the Regulation states that a debtor is in default if it is unlikely to pay its credit obligation to the bank without the bank having recourse to measures such as the realisation of collateral.

According to the European Banking Authority's guidelines, banks are entitled to interpret the criteria for unlikelihood of payment under Article 178 (3) of the Regulation.<sup>3</sup> Consequently, the bank argued that it had made use of its right of interpretation and had thus considered that the initiation of *conciliation* fell within the scope of a sign of possible unlikelihood of payment under Article 178 of the Regulation.

Despite the bank's arguments, the court held that the initiation of a *conciliation* procedure does not constitute an event of default within the meaning of Article 178 of the Regulation. As a result, the bank is bound by the confidentiality of the *conciliation*, notwithstanding the fact that:

- (i) the bank was not a party to the *conciliation*; and
- (ii) the information was provided by the debtor itself.

The most surprising aspect of this ruling seems to be its disregard for European rules, i.e. the Regulation, which is directly applicable in all Member States. By deciding that the confidentiality of preventive proceedings takes precedence over the regulatory obligations of banks, the French Supreme Court has ruled against the purpose of the Regulation and undermined its scope. Indeed, with such a ruling, France now appears to have introduced into national law an "exemption regime" from regulatory obligations for banks.

Moreover, the declaration of default as defined in the Regulation is essential for the central bank authority to take the necessary action in terms of rating, thus informing the market

of the financial health of the various players. By asking banks not to comply with their regulatory obligations, debtors may continue to present a distorted picture of their true financial situation.

Ultimately, this puts the European financial system at risk. At the same time, this position of the French Supreme Court contradicts the notion of the *hiérarchie des normes* (hierarchy of rules) and raises the question of the possibility of an appeal to the ECJ for France's non-compliance with European law.

### Summary

In conclusion, this decision creates a dilemma for banks. According to this ruling, either banks continue to notify their supervisor of events of default (in accordance with Article 178 of the Regulation), thereby triggering their liability towards the debtor in the *conciliation* proceedings, or they stop notifying their supervisor of events of default, in which case they are in breach of the Regulation. ■

**Footnote:**

- 1 Cass. Com. 3 July 2024 no. 22-24.068.
- 2 Cass. Com. 15 December 2015, no. 14-11.500.
- 3 Paragraph 58, EBA/GL/2016/07 Guidelines.



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